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Marlene H. Dortch
Office of the Secretary
Federal Communications Commission
The Portals, 445 12th Street, S. W.
Room TW-B204
Washington, DC 20554

Re: *In the Matter of Section Sunset of the BOC Separate Affiliate and Related Requirements*, WC Docket No. 02-112; *In the Matter of Appropriate Framework for Broadband Access to the Internet over Wireline*, CC Docket No. 02-33

Dear Mrs. Dortch:

BellSouth provides this letter in response to *ex parte* letters filed by MCI[1] and AT&T[2] regarding cost allocation issues. Both MCI and AT&T filed these letters in response to BellSouth's proposals to the Commission to treat facilities used to provide interLATA and broadband services as regulated for cost allocation purposes. As demonstrated below, the arguments made by MCI and AT&T do not support the application of the Commission's cost allocation requirements to these services.

Under the Commission's current rules, any interLATA services offered by the Bell Operating Companies ("BOCs") must be accounted for as non-regulated. Additionally, the Commission is evaluating the regulatory classification of broadband services, including the underlying facilities used to provide those services, and considering whether to regulate them under Title I as opposed to common carrier regulation of Title II. In a proceeding addressing whether any, and if so what type of, regulation should apply to the BOCs' integrated interLATA services offerings post sunset of Section 272 and in the broadband proceeding, the Commission has asked parties to consider whether traditional Part 64 cost allocation rules should apply.

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1 Letter from Alan Buzacott, Senior Manager, Regulatory Affairs, MCI, to Michelle Carey, Chief, Competition Policy Division, Wireline Competition Bureau, Federal Communications Commission (Feb. 9, 2004), transmitted by letter from Gil M. Strober, Lawler, Metzger & Milkman, LLC, to Marlene Dortch, Secretary, Federal Communications Commission, WC Docket No. 02-112 & CC Docket No. 00-175 (Feb. 9, 2004) ("MCI Letter").

2 Letter from Michael J. Hunseder, Sidley Austin Brown & Wood LLP, to Marlene H. Dortch, Secretary, Federal Communications Commission, CC Docket No. 02-33 & WC Docket No. 02-112 (Feb. 13, 2004) ("AT&T Letter").

In past presentations BellSouth demonstrated that the Commission should not apply its Part 64 cost allocation rules, which would require a carrier to treat integrated interLATA and broadband services as non-regulated for accounting purposes.[3] BellSouth explained that investment used to provide these services should remain in the regulated accounting classification and not be allocated to non-regulated operations. This is not only consistent with the Commission's past decisions, but also with the current state of competition and rate regulation. Indeed, interLATA services are telecommunications services regulated under Title II. The proper accounting treatment for these services is to be included as regulated.[4] The Commission turned the concept of accounting for Title II telecommunications services offered by the BOCs on its head by requiring incidental interLATA services to be treated as non-regulated for accounting purposes. The Commission did this in the infancy of the 1996 Act; however, competition and regulatory changes, as discussed herein, obviate the need to perpetuate this unnatural conclusion any further.

MCI and AT&T cavil at BellSouth's proposals to include these services as regulated for accounting purposes simply to keep BOCs hamstrung with needless regulations. The Commission should be clear on the motives of MCI and AT&T, which are to saddle ILECs with as much additional cost as possible. To further this strategy, they regularly dust off their canned "cross-subsidy" and "price squeeze" arguments. These arguments always boil down to their claim that, unless extensive economic regulation remains in place, BOCs will load all of their costs for non-regulated services onto the regulated side of the house resulting in both an increase in prices for regulated services (cross-subsidization) and an ability to under-price their non-regulated services (price squeeze). MCI and AT&T have missed very few opportunities to exploit these arguments anytime a BOC has attempted to provide a competitive service. It is time for the Commission to state clearly that competition, along with existing price incentive regulation, is working as intended, and end the gamesmanship being played by MCI and AT&T.

The MCI and AT&T arguments are especially misplaced in this proceeding where the Commission is reviewing the potential regulatory treatment of BOC provision of long distance service, a service that is unquestionably highly competitive. The MCI and AT&T claims that the BOCs will engage in a price squeeze and cross-subsidization through exchange access rates are baseless given today's competitive environment and the existence of Section 272(e)(3).[5] BellSouth's proposal simply strengthens the existing Section 272 safeguards by codifying

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3 *See* Letter from Stephen L. Earnest, Regulatory Counsel, BellSouth Corporation, to Marlene H. Dortch, Secretary, Federal Communications Commission, CC Docket No. 02-33 (Aug. 26, 2003); Letter from Mary L. Henze, Assistant Vice President, Federal Regulatory, BellSouth Corporation, WC Docket No. 02-112, CC Docket No. 00-175 (Nov. 12, 2003).

4 Just as the Commission found in the *BOC Long Distance Classification Order*, BOCs should be regulated as non-dominant in the provision of these services even on an integrated basis.

5 *See, e.g.*, MCI Letter at 2 ("[P]ermitting the BOCs to treat interLATA costs as regulated, as BellSouth proposes, would create a risk that rates for non-competitive services, such as exchange access, would be higher than they would be if interLATA costs continued to be treated as unregulated . . . .").

Section 272(e)(3) in the Commission's rules, thus further ensuring that, from an access rate standpoint, providers of non-affiliated long distance services will be on complete equal footing with BOCs' provision of long distance services. Under BellSouth's proposal, a BOC would impute to its long distance services the tariffed access rate that the BOC charges non-affiliated long distance companies. Imputing its tariffed access rate to its own long distance services would place a BOC in the same position as any other carrier in providing these services. Moreover, despite MCI and AT&T's claims, the rates for exchange access services are capped under price regulation and cannot be increased by raising the cost attributed to providing the service. These two factors – the imputation protection afforded under section 272(e)(3) and price regulation – not the Part 64 cost allocation process, eliminate cross-subsidization and price squeeze concerns.

Realizing that there is no true basis for their arguments, MCI and AT&T instead attack the price regulation system. They claim that regulated costs still can cause a direct increase in access rates and that the obligations of Section 254(k) of the 1996 Act require interLATA services to be treated as non-regulated for accounting purposes and require the BOCs to allocate the investment used to provide these services between regulated and non-regulated.

I. The Claims Attempting to Link Costs to Price Increases for Regulated Services Under Price Cap Regulation Are Unsupported

The basic premise underlying MCI and AT&T's claims of cross-subsidization and price squeeze is that while price cap regulation may not be a cost plus regulatory system, costs still can impact the prices BOCs charge for regulated services. The examples they give are (1) states continue to use rate of return regulation and, therefore, need cost allocation for interLATA services; (2) in the 1996 *Accounting Safeguards Order,*[6] the Commission found that interLATA services needed to be treated as non-regulated even though price cap regulation was in effect and had been since 1991, thus the Commission must continue that reasoning in 2004 and beyond; (3) exogenous costs factor into the determination of the price cap formula and therefore costs remain important; and (4) cost allocation is necessary for pricing unbundled network elements ("UNEs").[7] None of these claims can withstand scrutiny when compared to current market conditions and the end result of price cap regulation.

6 Implementation of the Telecommunications Act of 1996: Accounting Safeguards Under the Telecommunications Act of 1996, CC Docket No 96-150, *Report and Order*, 11 FCC Rcd 17539 (1996) ("*Accounting Safeguards Order*").

7 AT&T speciously cites *Verizon v. FCC*, 535 U.S. 467 (2002) for the proposition that price regulation is not adequate to eliminate the continued need of Part 64 non-regulated cost accounting. The dicta from this case, however, can hardly be cited as a limitation on the Commission's authority over Part 64. The Court was merely providing an overview of rate-based proceedings including traditional rate-of-return regulation and the migration to price cap regulation. The Supreme Court noted that price cap productivity offsets and exogenous adjustments could lead to battles between the parties, not that Part 64 non-regulated cost accounting is required or necessary.

A. State Pricing Requirements

A recurring argument made by MCI and AT&T for why the Commission should not relieve federal rules for interstate services is that some states remain under rate of return regulation for intrastate services. This reason, of course, is inapposite to whether the Commission should impose arduous Part 64 cost allocation requirements on BOCs' interstate services. As BellSouth has discussed in various proceedings, all of the states in BellSouth's region have implemented price cap regulation for intrastate services. Moreover, even for states in other regions that have not implemented price caps, the regulation of intrastate services should remain in the state. There is no need to burden the entire industry with state specific concerns.

B. The *Accounting Safeguards Order*

The next argument advanced by MCI and AT&T in favor of cost allocation is based on the Commission's findings in the *Accounting Safeguards Order*. In that *Order*, the Commission considered how to treat and account for incidental interLATA services that the BOCs could provide on an integrated basis prior to obtaining relief under Section 271 of the 1996 Act. In the *Order*, the Commission considered, *inter alia*, whether the BOCs should account for such services as regulated or non-regulated. The Commission found that BOCs should treat these services as non-regulated, even though they are telecommunications services subject to Title II regulation. Significantly, when the Commission initially decided to account for regulated incidental interLATA services as if they were non-regulated, the sharing and lower formula adjustment mechanism ("LFAM") provisions were still operational under price cap regulation.

When it made the decision to require non-regulated accounting of incidental interLATA services, the Commission did so because of a desire to achieve "greater accuracy" than Parts 36 and 69 would provide.[8] The Commission also indicated, however, that "changes in the competitive condition of local telecommunication markets in the future may cause us to reexamine the continued need for our Part 64 cost allocation rules."[9] With the elimination of LFAM and sharing and with exogenous adjustments being outside of the control of the BOC, there no longer is a need for "greater accuracy." Reasonableness of rates, not greater accuracy, is all that is necessary. The Commission can come to the same conclusion here as it did in 2001 with the Part 36 Separations freeze, determining that "extreme precision is not required."[10] Indeed, in 1999 when the Commission eliminated LFAM for price cap LECs obtaining pricing flexibility, it did so because "we find that such cost accounting rules would make using the low-end adjustment mechanism just as burdensome as making an above-cap filing . . . . On the other hand, elimination of the low-end adjustment mechanism for an incumbent LEC might enable the

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8 *Accounting Safeguards Order*, 11 FCC Rcd at 17573, ¶ 76.

9 *Id*. at 17661, ¶ 271.

10 *Jurisdictional Separations and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, *Report and Order*, 16 FCC Rcd 11382, 11390, ¶ 12 (2001) ("*Separations Freeze Order*").

Commission to relax, for that LEC, any accounting rules necessitated only by the rate-of-return-based low-end adjustment mechanism."[11] Clearly, that time has come and the Commission should begin by ensuring that BOCs are not unnecessarily burdened by requiring cost allocation for investment used to provide interLATA services.

C. Exogenous Changes

Another argument expressed by MCI and AT&T is that the exogenous costs component of the price cap formula is dependent on the BOC's actual costs. MCI states "all exogenous cost changes prescribed in section 61.45(d) of the Commission's rules involve changes in the underlying regulated interstate costs of the price cap carrier, and require the carrier to adjust its price cap indices to reflect such cost changes."[12] While certain exogenous cost changes have in the past relied on supporting cost information, almost all remaining exogenous cost changes for BellSouth no longer require the underlying cost support contemplated by MCI and AT&T and thus offer no basis for requiring continued cost allocations.

By definition, exogenous changes are "triggered by administrative, legislative, or judicial action beyond the control of the carriers."[13] Exogenous changes represent items that would have had an impact on the July 1, 1990 data used to establish the initial price cap rates, but were not reflected in the initial rates. An exogenous change, if material, could either raise or lower the price cap index ("PCI"); however, if a BOC seeks such an adjustment, the Commission could conduct an investigation of a particular exogenous event.[14] Thus, continued regulation of costs to analyze an exogenous cost adjustment that could impact the PCI index is illogical and an immense waste of resources. The Commission would simply place the burden on that BOC to justify its costs. Thus, while it is not known to what extent, if any, costs will be used in the calculation of future exogenous cost adjustments, it is clear that any such event is certain to be evaluated on a case-by-case basis, and the BOC will have to provide sufficient detail to justify the exogenous cost determination.

MCI further identifies regulated to non-regulated reallocations as an exogenous adjustment that would require continued cost allocation. Reallocation is a situation where

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11 Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Interexchange Carrier Purchases of Switched Access Services Offered by Competitive Local Exchange Carriers; Petition of U S West Communications, Inc. for Forbearance from Regulation as a Dominant Carrier in the Phoenix, Arizona MSA, CC Docket Nos. 96-262, 94-1 & 98-157; CCB/CPD File No. 98-63, Fifth Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd 14221, 14306-7, ¶ 166 (1999) ("Pricing Flexibility Order").

12 MCI Letter at 2-3.

13 Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, *Order on Reconsideration*, 6 FCC Rcd 2637, 2662, ¶ 58 (1991).

14 *See e.g., Tariffs Implementing Access Charge Reform*, CC Docket No. 97-250, *Order Designating Issues for Investigation and Order on Reconsideration*, 13 FCC Rcd 2249, 2269, ¶ 47 (1998).

"events demonstrate that the carrier has underforcast the ratio of non-regulated use to total use."[15] The reallocation process was established when carriers were under rate-of-return regulation and the reallocation requirements "serve[d] to deter manipulative underforecasting of non-regulated usage and to mitigate the impact on ratepayers of unintended or unavoidable underforecasts."[16] The exogenous cost was the interest, initially calculated using the rate-of return, on the underforecasted amount.[17] The Commission carried over underforecasting to the price cap process because when the initial price cap rates were established, the results of BOC peak three-year forecast were included in those rates.[18] Once each forecast period ended and actuals were tracked, the BOCs were required to make an exogenous adjustment if the forecasts were understated.[19] Because the three-year forecast period in use in 1990 to establish the initial price cap rates has passed and the comparisons to actuals have already been made, this particular adjustment is no longer necessary.

D. Prices for Unbundled Network Elements ("UNEs")

AT&T contends that the Commission must require cost allocation for interLATA and broadband services because many of the cost models used to determine the forward-looking costs of UNEs rely on data from current costs that are reported after the application of the Commission's cost allocation rules as a starting point. The Commission should not be swayed by this argument for a number of reasons.

First, the costs of UNEs represent the forward-looking economic costs for elements of the telecommunications network. UNE costs do not purport to be the embedded historical costs of facilities or the cost of different services that are carried over the network elements. In this regard, the UNE cost study methodologies focus on determining the proper types and associated costs of equipment necessary, on a going forward basis, to support the provision of an element of the network, such as a subscriber loop, to a CLEC. The intent of Part 64 allocations was to address historical embedded investment and allocations of book cost between service categories so that there would be no cross-subsidization between regulated and non-regulated services. The Part 64 focus is not aligned with the objective of UNE cost studies and, therefore, is not necessary for the proper determination of UNE costs.

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15 Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities; Amendment of Part 31, the Uniform System of Accounts for Class A and Class B Telephone Companies to Provide for Nonregulated Activities and to Provide for Transactions Between Telephone Companies and Their Affiliates, CC Docket No. 86-111, Order on Reconsideration, 2 FCC Rcd 6283, 6291, n.105 (1987).

16 *Id.* at 6291, ¶ 64.

17 *Id.* ¶ 68.

18 Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, *Second Report and Order*, 5 FCC Rcd 6786, 6807, ¶ 171 (1990) ("Price Cap Order").

19 The Commission required the adjustment because "under the price cap plan, reallocation of regulated investment to non-regulated activities would not impact interstate rates." *Id.* at 6808, ¶ 172.

Second, even though current UNE cost methodologies may use certain factor relationships developed from historical regulated results as an expectation of similar cost relationships for forward-looking cost, this does not mean that Part 64 allocations are necessary for UNE cost studies. For example, a factor relationship that could be included in a UNE cost methodology is the specific expense for aerial metallic cable plant as it is related to aerial metallic cable investment. Whereas Part 64 rules would look to the type of traffic usage that is transmitted over the cable in order to allocate costs between regulated and non-regulated services, the information that is desired for UNE cost study purposes is how much plant specific type expense is required to maintain aerial metallic cable regardless of the type of traffic on the cable.

Finally, it is up to the company filing the UNE cost study to determine and defend the appropriate amount of forward-looking investment and expenses that are required to provision a particular UNE. Part 64 cost allocations are not a required or necessary part of UNE cost study methodologies. Therefore, using UNE cost studies as an argument to impose burdensome Part 64 cost allocations on incumbent carriers is without merit.

E. Other Issues

1. Cost Allocation Is Not Necessary for Calculation of the Price Cap Productivity Offset

Another factor put forward by MCI and AT&T as a need for continued cost allocation is that costs can affect the productivity factor element of the price cap formula. A simple understanding of the productivity or X-factor demonstrates this is not true. The productivity factor in the price cap formula constitutes "a measure of the amount by which LEC productivity exceeded that of the economy as a whole." [20] In the price cap formula, the productivity factor offset "subtracts the amount by which LECs can be expected to outperform economy-wide productivity gains." [21] This factor is established based on economic inputs; not on Part 64 allocated results. The BOCs have no control over the Commission's determination of this value. The current productivity factor is codified in the Commission's rules at 6.5%[22] and will remain as is until the Commission establishes another proceeding for its review.

2. Maintaining Outdated Reporting Requirements Is No Reason to Require Unnecessary Cost Allocation

MCI inductively reasons that "[a]s long as the Commission requires price-cap carriers to file Form 492A, the Commission should ensure that the reported data is reliable and enables the Commission to have a clear understanding of the interstate earnings of price cap carriers for

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20 *Price Cap Order*, 5 FCC Rcd at 6796, ¶ 74.

21 *Id.*

22 47 C.F.R. § 61.45(a), (b).

regulated, interstate services."[23] The irony of this claim is that the purpose for the 492A no longer exists, and the form is no longer necessary. Form 492 was originally designed to monitor a carrier's earnings for the purpose of interstate rate-of-return regulation.[24] This form was later modified and used to monitor interstate price-cap sharing.[25] BOCs are no longer regulated under interstate rate-of-return regulation, and BOC price cap regulation no longer contains a sharing or low-end adjustment provision.[26] Thus, instead of using the form as a reason for requiring BOCs to continue to allocate costs, the Commission should eliminate Form 492A. Until the Commission eliminates the form, however, BOCs can treat broadband and interLATA services in the same manner as price flex services by removing these services from the 492A report.[27]

3. Cost Allocation Is a Costly and Burdensome Process

AT&T questions the burden of applying cost allocation to broadband and interLATA services. The BOCs are all too familiar with the burdens associated with allocating costs between regulated and non-regulated activities because they have been required to follow Part 64 cost allocation rules for 17 years. The cost allocation audits required by the Commission to be performed every two years typically take 10 months to complete and exceed $1 million per year in fees and man-hour costs, per operating company.

The Commission has long recognized the complexity of allocating network facilities and the task is made even harder by the advent of packet technology.[28] In the case of integrated long distance service, it will be virtually impossible to identify use for local (regulated) services and use for long distance services (also regulated but treated under current accounting rules as non-regulated) in order to allocate properly the network facilities. And, even if the Commission mandates an allocator, it can only be developed out of thin air, making any allocation of costs completely arbitrary.

AT&T's claim that BOCs never explained why it would be unduly burdensome to separate interLATA and broadband costs, but not be burdensome to separate costs in other proceedings, such as the ban against provision of operating, installation and maintenance

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23 MCI Letter at 4.

24 *See* Form 492A Line 5 – Rate of Return.

25 *See* Form 492A Line 6 – Sharing/Low End Adjustment Amount.

26 *See Price Cap Order*, 5 FCC Rcd at 6833, ¶ 380 ("Our sharing and adjustment mechanisms are based on total interstate rate of return, and that is the only earnings data used in the price caps plan.").

27 In addressing the preparation of Form 492, the Commission determined "[a]s in previous annual filings, the earnings of services excluded from price cap treatment should be removed based on the assumption that the excluded services earned the same interstate rate of return as price cap services." *Material to be Filed in Support of 2004 Annual Access Tariff Filings*, WCB/Pricing 04-15, *Tariff Review Plans*, DA 04-1048, ¶ 21 (2004).

28 *Allocation of Costs Associated with Local Exchange Carrier Provision of Video Programming Services*, CC Docket No. 96-112.

services ("OI&M") between a BOC and its separate Section 272 affiliate, is merely an attempt to obfuscate the issue. In providing OI&M service to a Section 272 affiliate, the BOC would perform work on the facilities owned by the Section 272 affiliate. These facilities are uniquely identifiable. Indeed, the Commission continues to prohibit the joint ownership of facilities between the BOC and its Section 272 affiliate. Thus, the provision of OI&M services to the 272 affiliate will simply require the proper record keeping of employees', especially technicians', time in order to determine the fully distributed costs for that service. Allocation of network facility costs is not a factor.

The apportionment of an integrated network is an entirely different matter and virtually impossible to determine with current technology. When the Commission developed and implemented the Part 64 apportionment rules, the technology and regulatory pricing landscape was very different from today's environment. At the time of implementation, carriers were governed by rate of return regulation and technology was such that the nature of individual calls could be tracked. A "long distance" call was handled through the technology differently from the "local" call. Since that time, however, technology has migrated to the use of packets, rather than the slow call-by-call format. Packet transmissions could contain "local " calls, "long distance" calls and Internet messages. The entire packet is transmitted together. Thus, allocation of the network such that interLATA, or long distance, calls would ride over the non-regulated portion of the network while local calls would remain on the regulated portion is infeasible. That is why it would be devastatingly burdensome on BOCs to have to apply Part 64 to interLATA calls if the Commission deemed them to be non-regulated after integration. BellSouth's recommendation to have BOCs apply access charges for the use of the network to interLATA and broadband services on the same basis that they apply these charges to other carriers puts the unaffiliated carriers on equal footing with the BOCs and eliminates the need to apportion the network.

II. Cost Allocation Is Not Necessary for Section 254(k) Compliance

As an initial matter, AT&T claims that Congress did not believe price caps could by themselves prevent cost misallocations and, therefore, created Section 254(k). This argument fails under the current price cap structure. At the time Congress adopted Section 254(k), BOC price cap regulation contained both sharing and the LFAM provisions, which were linked to Part 64 cost results. Just as with many of the arguments discussed above, under the current price cap regulation for BOCs, the Part 64 cost results do not factor into price changes.

The bulk of MCI and AT&T's claims regarding the need for Part 64 cost allocation in order for the Commission to comply with Section 254(k) centers on the second sentence of that section, which states "[t]he Commission, with respect to interstate services, and the States, with respect to intrastate services, shall establish any necessary cost allocation rules, accounting safeguards, and guidelines to ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services."[29]

Before addressing MCI and AT&T's specific claims, it is important to preface the entire discussion with the understanding that Section 254(k) only applies to the services that qualify for universal service, and not to all services. The second sentence of 254(k) requires that services that qualify for universal service bear no more than a reasonable share of joint and common costs. This sentence does not address how a carrier must account for a service. It does not mandate that a carrier account for interLATA and broadband services, or any services for that matter, as non-regulated. In addition, the second sentence of 254(k) does not apply to UNE pricing.[30] Indeed, the Universal Service *Input Order* itself cautioned parties against using the USF value for other purposes such as determining prices for UNEs.[31]

Moreover, in its *Universal Service* proceeding, the Commission has determined that the way to comply with Section 254(k) is to limit the amount of overheads to a reasonable per-line amount.[32] The Commission achieved the statutory obligations of Section 254(k) through the universal service model process, not the Part 64 process. In fact, the use of Part 64 was not even germane to the process for several reasons. First, Part 64 data does not represent forward-looking costs. Furthermore, universal services were not uniquely identified in the Part 64 process when the inputs for the non-rural USF model were developed and continue not to be uniquely identified in the Part 64 process.[33] Instead, the Commission used a reasonable estimate

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29 47 U.S.C. § 254(k). *See* AT&T Letter at 9 ("But neither MCI nor AT&T is contending that the Commission should in this rulemaking proceeding determine whether the Bells would in fact be engaging in cross-subsidies . . . . Rather, MCI and AT&T have both argued that the Commission would violate the *second* sentence of Section 254(k). . . .").

30 *See* AT&T Letter at 5.

31 See Federal-State Joint Board on Universal Service; Forward-Looking Mechanism for High Cost Support for Non-Rural LECs, CC Docket Nos. 96-45 & 97-160, Tenth Report and Order, 14 FCC Rcd 20156, 20172, ¶ 32 (1999) ("Universal Service Inputs Order").

32 *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Report and Order*, 12 FCC Rcd 8776, 8930-31, ¶ 283 (1997) ("In order to ensure that carriers use universal service support only to offer better service to their customers through prudent facility investment and maintenance consistent with their obligations under section 254(k), we shall limit the amount of corporate operations expense that may be recovered through the support mechanisms for high loop costs . . . . [W]e intend to limit universal service support for corporate operations expense to a reasonable per-line amount, recognizing that small study areas based on the number of lines, may experience greater amounts of corporate operations expense per line than larger study areas.").

33 The Part 64 process does not allocate costs to individual services. *See Separation of costs of regulated telephone service from costs of non-regulated activities; Amendment of Part 31, the Uniform System of Accounts for Class A and Class B Telephone Companies to provide for non-regulated activities and to provide for transactions between telephone companies and their affiliates*, CC Docket No. 86-111, *Report and Order*, 2 FCC Rcd 1298, 1304, ¶ 40 (1987) ("*Joint Cost Order*") ("It is not our purpose, nor should it be our purpose, to seek to attribute costs to particular nonregulated activities . . . ."); *id.* at 1313, ¶ 115 ("...by treating the regulated and nonregulated sectors of company's business in the aggregate for purposes of allocating costs").

of forward-looking overheads, and not the Part 64 data, for the nationwide un-separated per-line overhead rate that was input to the Universal Service cost model.[34]

Regarding overheads, the *Universal Service Input Order* determined the non-rural overhead amount per line to be $7.32 per month.[35] This estimated overhead rate has not changed. Because aggregated Part 64 data was initially used as a starting point for determining the established overhead per-line rate does not mean that the Commission must go back to the beginning if it elects to adjust this rate in the future. Indeed, the starting point for updating the overhead per-line rate would be the rate that already exists, not Part 64. This is further support that Part 64 is no longer necessary for compliance with the second sentence of Section 254(k).

Finally, Part 64 results cannot be used to determine investment for the USF. As the Commission has indicated, the investment used in the USF model is the "least-cost, most-efficient" technology as well as the "current cost of purchasing facilities and equipment."[36] The Part 64 process allocates embedded, not forward-looking costs, and the Part 64 process does not identify services supported by universal service.

Respectfully submitted,

Stephen L. Earnest

SLE:lb
cc: Michael Carowitze

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34 The sole use of Part 64 ARMIS results by the cost model process was to initially collect aggregated data to be used as a starting point from which many additional adjustments could be made. The cost data collection and adjustment processes are now complete. It is the cost model itself, not on-going provision of cost data by BOCs, that is used to determine both the national average and state-wide average forward looking economic cost, *see* 47 C.F.R. § 54.309(a)(1), (2). BOCs continue to report access lines, and not cost dada, to the Universal Service Administrative Company ("USAC"). *See Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Ninth Report & Order and Eighteenth Order on Reconsideration*, 14 FCC Rcd 20432, 20481, n.248 (1999) ("Because the forward-looking support mechanism provides support based on costs estimated by the Commission's cost model, non-rural carriers will be required to file loop-count data, but not cost data, in order to receive forward-looking support under Part 54.").

35 *See Universal Service Inputs Order*, 14 FCC Rcd at 20321, n.855 (this note illustrates this point stating "[r]ather than using the $7.32 directly as an input value, the model uses this amount, annualized and adjusted for uncollectibles or $92.46316, which appears in cell C33 of the per line tab of the wire center expense module.").

36 *Id.* at 20171, ¶ 29.